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SUBJECT: CITIBANK'S LOCAL INCORPORATION PROBLEMS

REF: A) SHANGHAI 478; B) SHANGHAI 161; C) GUANGZHOU 850

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11. (SBU) Summary: In a meeting with Federal Deposit Insurance Chairman (FDIC) Sheila Bair on July 26, Citibank (China) Chief Executive Officer Richard Stanley opined that the China Banking Regulatory Commission was "making it up as they went along" with regard to the treatment of newly locally-incorporated foreign banks such as Citibank. Citibank was facing unprecedented level of intrusiveness and forced change on the bank. Citi was still not permitted to issue a debit card to its RMB customers and was experiencing management problems with its partners at the Guangdong Development Bank. According to American businessmen who participated in a roundtable with Bair, China faced enormous challenges overcoming the risks associated with corruption in designing and implementing a banking deposit insurance program. End Summary.

12. (SBU) Federal Deposit Insurance Corporation (FDIC) Chairman Sheila Bair met with Citibank (China) Chief Executive Officer Richard Stanley and Citibank Director of Government Affairs-China Vice President Jie Huang on July 26. Also, on July 26, Chairman Bair attended an Amcham-hosted business roundtable. Chairman Bair was joined during her July 26-27 visit to Shanghai by FDIC Vice Chairman Martin Gruenberg, FDIC Director of International Affairs Fred Carns and FDIC Chief of Staff Jesse Villarreal. Chairman Bair's July 27 meeting at the Shanghai Stock Exchange was reported Ref A; other FDIC delegation meetings will be reported septel.

Citibank Not Pleased With Local Incorporation

13. (SBU) Citibank's Stanley said that Citi was "not pleased" with having been required to incorporate locally as a Chinese bank due to the "challenging complexities" this change had created. Stanley was optimistic, however, that Citibank could work through these complications. He reiterated to Chairman Bair his previously reported (Ref B and previous) view that any bank not already in China would find it prohibitively costly to set up business here due to Chinese regulations.

14. (SBU) Stanley said that in terms of how to treat the newly locally-incorporated foreign banks, the China Banking Regulatory Commission (CBRC) was "making it up as it went along." He said that while the CBRC had initially approved the names submitted to act as Citibank's independent board in China, Citibank recently was told that the board needed to include "a Mainland person," and that the CBRC was again reviewing Citi's board membership.

15. (SBU) "The CBRC is pushing a level of intrusiveness and forced changes on Citibank" that Stanley had not expected. Citibank was being forced to adopt Chinese banking practices "immediately." Stanley said that Citibank was also facing interference from non-CBRC officials as well. He said, for example, that the local police had inspected a Citibank branch in a second-tier city and informed Citibank that they needed to construct a different style vault for "security reasons."

16. (SBU) Despite being forced to act as a local Chinese bank, Stanley said that Citibank was still not able to issue debit cards to its RMB deposit customers. Stanley said that despite the facts they were locally incorporated and therefore a "Chinese bank" and should be able to issue debit cards like every other Chinese bank, but the regulators "wanted to slow Citi's growth and restrict capital inflows." The excuse given by the CBRC to deny Citibank's issuance of the cards was that

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the People's Bank of China (PBOC) had some unspecified "certification test" that Citi needed to pass. No one at either the CBRC or the PBOC, however, "knew what the test was." While he expected this issue to be resolved soon, he said it was clear that the CBRC was using stalling tactics to enable Chinese banks to "get there before the foreign competition."

17. (SBU) Nevertheless, Stanley said, "the good news is that the market is hot and we are making money."

Problems With Guangdong Development Bank

18. (SBU) Stanley said that Citibank's investment in the Guangdong Development Bank (GDB) had not gone as smoothly as he had hoped. Citibank had "management influence" at GDB, "but not control." "There have been some issues with our consortium partners and resistance to change," he said. There had been problems with GDB's Communist Party Committee as well. (Note: See Ref C. End note.)

19. (SBU) Eight of the top 13 people at GDB are seconded-Citibank employees; this gives Citibank "blocking rights, but not outright control." GDB was now capitalized to 6+ percent and had a non-performing loans (NPL) book of only 5 percent. Stanley expected that GDB would be capitalized to 7.2 percent by the end of 2007. Since Citibank and its partners took it over, GDB has earned \$300 million in profits and was in the process of raising more capital.

Recapitalizing Rural Cooperatives

110. (SBU) Responding to a query from Chairman Bair, Stanley said that there was "tremendous interest" by foreign capital to enter China's financial sector. Given the difficulties and barriers that banks not already present in China would face entering the

market, Stanley believed that there would be banks interested in recapitalizing and consolidating China's ailing rural cooperatives. This would be the "best way for the next wave of foreign banks to get a piece of China's banking sector. But this would be very hard to do organically," he said.

¶11. (SBU) Citibank had already brought some of its India-based employees to China to discuss their success with similar programs in India. However, the challenges, such as management controls, accountability, and finding appropriately-trained staff to live and work in these areas would be immense. Furthermore, Stanley doubted that regional governments would be willing to sever their controlling ties over the local banks. "Not in this generation; it is not going to happen," he said.

Implementing Deposit Insurance Would Be Difficult

¶12. (SBU) Chairman Bair discussed China's business climate and China's need for a deposit insurance system with U.S. businesses at a roundtable hosted by the American Chamber of Commerce (Amcham) on July 26. Also attending was KPMG Assistant Manager Paul Watson, Javelin Investments Chairman Kim Woodard, ChinaVest Senior Vice President Erik Bethel, Huangpu Enterprise Development Corp. CEO Eugene I-Chun Wang, AIU Insurance Shanghai Branch Assistant Vice President Eric Zhang, and Bank of America Senior Vice President Leehun M. Lee.

¶13. (SBU) ChinaVest's Bethel said that the Chinese government had undergone a "tectonic shift" from ownership of the means of production to a regulator over independent companies. Every

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bank wanted to follow the success of the Industrial and Commercial Bank of China (ICBC) and list on the market. Banks therefore need to "clean themselves up" and deal with their nonperforming loans and other structural problems. The stock market was a catalyst promoting banking sector reform. A deposit insurance system for banks in China would be a beneficial step for both banks and the government, he said.

¶14. (SBU) Javelin Investment's Woodard agreed, but noted the "serious risk of corruption in the system." He outlined as one of China's endemic problems the fact that there was a serious disconnect between rules and regulations and actual behavior. Strong and independent regulatory oversight of the bank deposit insurance program would be one solution to this problem, "but it was difficult to envisage how this would be executed," he said.

¶15. (SBU) Huangpu Enterprise Development Corp.'s Wang noted that under the current system, bank customers assumed that the government would guarantee their savings even if the bank lost money due to corruption and embezzlement. This was one reason why Chinese continued to put money into savings accounts despite the zero percent real interest rate they earned on these deposits.
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